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Supreme Court, U.S.
FILED
OCT 6 1997
CLERK

No. 97-137

IN THE SUPREME COURT OF THE UNITED STATES
October Term, 1996

TOM ANDERSON, *Petitioner,*
v.
COMMISSIONER OF INTERNAL REVENUE, *Respondent,*

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE NINTH CIRCUIT

REPLY TO BRIEF IN OPPOSITION

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ADDITIONAL QUESTION PRESENTED

WHETHER income tax must be laid upon the party who earned the income by means of capital investment of intellectual property in a business venture and who did not immediately receive and hold the income, or whether a tax may be laid upon the Taxpayer who temporarily controlled the income.

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INTRODUCTION

Recent Senate hearings clearly signify the importance, lack of deterrent, and national need for the Court to address the issues presented in this case. For the first time in history, the Senate Subcommittee on Taxation and IRS Oversight held oversight hearings into the tactics, management, and inner workings of the IRS. Although the statements and testimony were not specifically directed to this case, they corroborate the issues, and supplement the petition.

> "There is no other agency in the country that directly touches the lives of more Americans....With such power, there must be an effective counterbalance of responsibility. Why? Because the greater the power, the more extensive the damage that can be done if that power is abused.... Any agency with such power must be above reproach.... Unfortunately, our investigation to date has found that in many cases, such high standards are not being upheld. Over the course of the next three days, we are going to see a picture of a troubled agency. One that is losing the confidence of the American people, and one that all to frequently acts as if it were above the law. This is unacceptable.... It is important to understand that these witnesses are typical of far greater numbers who have been moved to contact the Committee. These individuals serve as a sampling which demonstrates the significance of problems and concerns with the agency."— IRS Oversight Hearings, 09/23/97, Statement of Senator Roth, Chairman.

STATEMENT

OMNIBUS TAXPAYER BILL OF RIGHTS

To this day, the Commissioner continues an absolute fraud on the courts. The Commissioner alleges that in 1990, the Taxpayer hired a representative, participated in an IRS examination, and was uncooperative (Opp. Br. 4, 8). The Commissioner's internal records show: (1) such a representative had not even met the Taxpayer five months into the Para Tech examination (9th Cir. tab 40); (2) the Taxpayer did not file a power of attorney until 1992 (9th Cir. tab 6, 57); and (3) The Commissioner made no effort to contact the Taxpayer and conduct an examination. The fees were paid by Para Tech, not the Taxpayer in this case (Pet. App. 33a).

The Para Tech representative was hired by the Para Tech trustee (9th Cir. tab 32, 40) and provided Para Tech information to the

Commissioner in response to information and document requests issued exclusively to Para Tech and no other taxpayer (Jt. Exh. 369-NE, 377-NM, 380-NP–383-NS.). The Commissioner sought information from Para Tech, and Para Tech provided all the requested information within its possession or control.

The Commissioner also sought information about other parties, but never made a request to those other parties for the information sought (*ibid.*). Early in the examination of Para Tech, the Commissioner learned that a Chilean individual earned the income at issue (9th Cir. tab 40). At no time did the Commissioner issue examination correspondence, information and document requests, or serve a summons on Atram or the Taxpayer. However, the Commissioner elected to exercise summons authority for Atram bank records.

DETERMINATION OF DEFICIENCY

In 1991, the Commissioner issued a deficiency notice to Para Tech. Stated on the face of that notice (Jt. Exh. 7-G) is the determination that Para Tech "has been converted from a domestic trust to a taxable corporation for tax purposes under IRC. S. 7701." The Commissioner asserts that the deficiency issued at the same time to the Taxpayer was for income allegedly received *from* that Para Tech corporation (Opp. Br. 4). Thereafter, the Commissioner determined Atram to be a corporation, issued a formal notice, TIN, and corporate tax returns (Pet. Exh. 425; 9th Cir. tab 24-26).

LOWER COURT ERROR

The Taxpayer completed only the 8th grade, then grew up in a religious community in India (Pet. App. 9a). A sole proprietor at age 22, the Taxpayer performed services based on the technology from an aerospace engineer at McDonnell Douglas Astronautics and Hughes Aircraft (9th Cir. tab 62). Para Tech manufactured products based on a capital investment of technology from a Chilean professor in mathematics (Res. Exh. PK; Pet. Exh. 420-426, CR 58). The Taxpayer was not the developer of highly complex video technology that earned hundreds of thousands of dollars in revenue.

The Commissioner claims that Para Tech provided the same services as the Taxpayer's sole proprietorship (Opp. Br. 2). The Taxpayer's sole proprietorship was operated out of his $350/month apartment and barely broke even (RT 115, 138). Para Tech set up operations at a different facility in another city, received a capital investment of foreign intellectual property, manufactured products,

and did not provide repair services (RT 70, 79, Chile *supra*). Para Tech sales increased greatly as a direct result of the capital investment of intellectual property (Pet. App. 14a). Para Tech operations were substantially and materially different than the Taxpayer's previous sole proprietorship, and that difference is precisely what generated the profit the Commissioner sought to tax.

Consistent with the termination of his sole proprietorship, the Taxpayer closed that bank account. The Commissioner asserted that the Taxpayer did not have any bank account (Opp. Br. 3), despite having the knowledge and records showing that the Taxpayer maintained a Shearson money market checking account (9th Cir. tab 18).

All Para Tech bank accounts were opened by its trustee and agents (Res. Exh. PC–PF), not the Taxpayer (Opp. Br. 3).

The Taxpayer was not required to reimburse Para Tech for its business expenses, nor reimburse Atram for compensation due the Taxpayer as beneficiary (Opp. Br. 3). The statutory determination of the Commissioner, as shown on the face of the Para Tech deficiency notice (Jt. Exh. 7-G), was that all Para Tech business expenses were accepted as ordinary and necessary, including those later alleged to be personal income of the Taxpayer (e.g. Pet. 21). All direct and indirect benefits paid from Atram accounts constituted compensation to the Taxpayer from the business venture. All evidence showing direct or indirect compensation is consistent with the Taxpayer's 4% ownership interest in the business venture.

ARGUMENT

Omnibus Taxpayer Bill of Rights

The Omnibus Taxpayer Bill of Rights required the Secretary of the Treasury to prepare a statement which sets forth the rights of a taxpayer and obligations of the IRS during an audit, and administrative procedures available to a taxpayer, *et al.* P.L. 100-647 §6227, 102 Stat. 3731, (Pet. App. 47a).

The Commissioner implies that no authority outside U.S.C Title 26 is binding (Opp. Br. 8), such as the Constitution or Treasury regulations. The Commissioner argues that the provisions set forth in the Secretary's statement alter existing law (*ibid.*), when no other legislation or judicial precedent exists relating to those provisions.

The Commissioner misconstrues 26 C.F.R. part 601 to set forth administrative procedures and rules available to all taxpayers, while correctly showing that they have no binding effect (*id.* 7-8). The part 601 provisions merely describe the administrative privileges which

may be granted a taxpayer at the discretion of the Commissioner. They are not rights at all, and have no relevance to this case. Even if they were altered by the Secretary's statement, they are nonbinding rules established by the Commissioner which are superseded by delegated legislation promulgated by the Secretary.

The Commissioner simply denies that the Secretary's statement is delegated legislation, a legislative rule, or a regulation, and cites no supporting authority (*id.* 7). The Commissioner apparently asks this Court to place unconstitutional restrictions on the manner in which Congress is permitted to delegate the authority to legislate rules. It would seem the Commissioner can only plead not to be held accountable to the American people or their Congress.

> "Does the IRS cover up instances of taxpayer abuse? The answer is yes. If the true number of incidents of taxpayer abuse were ever known, the public would be appalled. If the public also ever knew the number of abuses covered up by the IRS, there could be a tax revolt. Why do we not know of these covered up abuses? The answer is simple. The IRS protects itself by management support of management actions, whether those actions are right or wrong. This acceptance of abusive actions by management is the root cause of taxpayer abuse." — IRS Oversight Hearings, 09/25/97, Testimony of Protected Witness #1, Revenue Officer for 20 years.
>
> Senator Breaux: "What effect do you all think that the adoption of the Omnibus Taxpayer Bill of Rights and the Taxpayer Bill of Rights 2 have had on the overall operations of the IRS?"
>
> #1: "It has had very little effect on the conduct of the IRS. The Taxpayer Bill of Rights is very positive. But, who is going to enforce this for the taxpayer?"
>
> #3: "They didn't like to see it. They looked for ways around some of the provisions, or they tried to ignore the provisions. They certainly never enforced the provisions."
>
> #4 "I really don't see any improvement at all."
>
> Senator Breaux: "So there is no outside organization or ombudsman or whatever to enforce what we pass?"
>
> #1 "Absolutely not. That is why you need an independent third party to help rule on these things." — IRS Oversight Hearings, 09/25/97; Testimony of Protected Witnesses: #1 Revenue Officer for 20 years, #3 Grade 12 Revenue Officer for 35 years, #4 Revenue Officer for 25 years.

Without precedent and remedy from the Judicial branch, no deterrent exists against the Executive branch abuses which the Legislative branch sought to cure with the Taxpayer Bill of Rights.

> "Proven violations of criminal misconduct [by] IRS employees have been whitewashed by IRS management and labor relations. Serious violations have resulted in nothing more than counseling letters. These letters are often removed from an employee's personnel file after a year. This kind of action does not serve as a deterrent from misconduct." — IRS Oversight Hearings, 09/25/97; Testimony of Protected Witness #2, IRS internal security criminal investigator for 20 years.
>
> "A track record of falsehood and misrepresentation [exists].... The current atmosphere is one of impunity, arrogance, and indifference. Three generations of nationwide surveys of IRS employees bears this out. For example, ... instructions dealing with employees stated that it was acceptable and permissible to lie and mislead, as long it accomplished the goals and mission of the agency.... I have observed little or no accountability for misconduct, mistakes, or errors, whether innocent or intentional."— IRS Oversight Hearings, 09/25/97; Testimony of Protected Witness #5, Revenue Officer.
>
> Senator Kerrey: "It is a question of are we going to manage according to the law... The answer today as I hear it is no."
>
> #4: "A whole lot of what is done day to day, is done with a wink and a nod. Nobody is called to task for the things that they do wrong." — IRS Oversight Hearings, 09/25/97; Testimony of Protected Witness #4, Revenue Officer for 25 years.

In this case, the greatest tax could be assessed only by ignoring facts, and denying the administrative procedures set forth in the Secretary's statement. The Commissioner never once contacted the Taxpayer or Atram in order to substantively determine who earned how much income. There was no examination of the Taxpayer with which he could cooperate. ~~Para Tech was exclusively represented~~ To prejudice the Taxpayer with the burden of production and persuasion in court, the Commissioner failed to develop the facts at the administrative level where additional evidence could have been informally produced if necessary.

DETERMINATION OF DEFICIENCY — BLUE SKY ASSESSMENT

The Commissioner places the issue of determining a deficiency and subsequent Tax Court jurisdiction squarely before the Court (Opp. Br. 7-8). Either the Commissioner must apply administrative procedures and substantively determine the income earned and tax reported by a taxpayer, or the Commissioner need only write a number on a piece of paper in order to lay income tax and convey jurisdiction upon the Tax Court. The Commissioner fundamentally argues that the form of a deficiency notice supersedes the substance and economic reality. This practice was described in the IRS oversight hearings as "blue sky assessment."

> Senator Roth: "Are you aware that the data of the Bureau of Labor Statistics are used by IRS employees to create phantom income or inflate a taxpayer's income? ... Aren't you supposed to have their actual income, their actual expenses?"
>
> Commissioner: "I have had people raise questions about whether if you push that too far, whether you get the wrong results. And I think it is possible you do. But that is the instance in which they are used, and that would be what I think would be a legitimate usage." — IRS Oversight Hearings, 09/25/97.

Essentially, the Commissioner argues for a power unlimited by the 16th amendment to the Constitution and the laws enacted thereunder, as long as income tax is laid in writing.

> "Right now, and during all of my experience with the IRS, the regions were functioning as fiefdoms where the person in charge, the regional commissioner or the regional counsel in the appropriate case, was considered a prince. Whereas the Commissioner or the chief counsel was the king. They were like royalty. They decided what they wanted to do, and they did it.... Employees were given mandates by management to take positions known to be incorrect, in order to obtain preordained results." — IRS Oversight Hearings, 09/24/97, Testimony of Lawrence Lilly, former IRS district counsel, 28 years experience.
>
> "The truth is that the IRS often does not operate within its proper authorities.... Such conduct shows complete disregard for the taxpayer and their fundamental rights as citizens. The implementation of this concept is that the IRS now has the 'authority' to assign additional income to the taxpayer at its discre-

> tion, without having any basis in fact. [This] is frightening and absolutely unacceptable." — IRS Oversight Hearings, 09/24/97, Testimony of Bruce Strauss, former IRS collection division chief, 31 years experience.

The safeguard against such power is that the law must be regarded with substance, and enforced with deterrent effect. Although undefined, the statutory term "determine" should mean a substantive discovery of facts through the administrative procedures set forth in the Secretary's statement. "If the words are doubtful, the doubt must be resolved against the government and in favor of the taxpayer." *U.S. v. Merriam*, 263 U.S. 179, 188 (1923).

The Commissioner has a duty to determine the substance of the transactions. *Lucas v. Earl*, 281 U.S. 111, 114-115 (1930). The Commissioner was informed that the business venture was substantially owned by a Chilean (9th Cir. tab 40). The U.S. lacked a tax treaty with Chile. The Commissioner's only recourse was to exceed his statutory authority with a blue sky assessment against the Taxpayer.

The Revenue Agent in the case testified that the amount of income received by the Taxpayer was not known, that deficiencies were issued to extract information, and that no distributions were found to the Taxpayer (RT 254-255). The Commissioner could not have possibly determined the amount of income received by the Taxpayer with any factual basis. The notice of deficiency was not authorized by statute, and the Tax Court lacked jurisdiction.

> "Some IRS auditors and tax collectors have taken the position that the provisions of the Internal Revenue Code are simply guidelines that they are free to accept or reject at will. If IRS employees do not follow the law and if they commit perjury before federal judges, their conduct is often condoned by their superiors including those at the highest level." — IRS Oversight Hearings, 09/24/97, Testimony of Robert Schriebman, retired tax professor.

DETERMINATION OF DEFICIENCY — WHIPSAW TECHNIQUE

The Commissioner proposes that when one taxpayer is examined, many taxpayers should understand that they are also under examination (Opp. Br. 8). This practice exceeds the Commissioner's statutory authority under the 16th amendment.

> "Assessment action may be taken against those whom the IRS knows have no liability for a particular tax. These include par-

> ents, relatives, and company employees against whom action is taken in order to get the real taxpayer to comply.... This is called the 'whipsaw technique.' This practice was explained to [the committee], 'when we go after everybody, we know somebody will pay.'" — IRS Oversight Hearings, 09/23/97, Statement of Senator Roth, Chairman.

In this case, the Commissioner's attorney declared the policy (RT 218): "We're just kind of holding you hostage, but the government has to get its money somewhere." The Revenue Agent in the case testified:

> "The problem, we don't - we don't what was the amount either of them had received.... We would have liked very much to get all of the players who were in the Atram Investment Group in Grand Turk Is., but that information was not given to us. The only persons that we knew were the trustee and [the Taxpayer]. And that is why we set up the tax to both those parties, hoping that somewhere down the line we would - it would reveal who are the recipients." (RT 254-255)

As the Commissioner argues (Opp. Br. 5), The first principle of taxation is that income is taxed to the one who earns it. *Commissioner v. Culbertson*, 337 U.S. 733, 739-740 (1949). This implies that the first principle in determining a deficiency is determining the substance and economic reality of who earned what. The Secretary's statement sets forth the necessary administrative procedures.

The Commissioner's internal records show that an internal examination file was opened on the Taxpayer with no examination action (9th Cir. tab 42). There was no correspondence, no information requests, no interview, and no examination time charged by the Revenue Agent (*id.* 42-48). The Taxpayer was summarily designated a "tax protester" involved with a "tax evasion scheme," was accused of refusing to be examined or provide information, and was subject to criminal referral (*id.* 6, 39, 44-48, 50, 52). The Commissioner did everything without once contacting the Taxpayer.

> "I can personally attest to the use of egregious tactics used by IRS Revenue Agents, which are encouraged by the members of the IRS management.... Please understand that many agents are encouraged by management to pursue tax assessments that have no basis in tax law. If a taxpayer objects or complains, every effort will be made by the IRS to run up their tax assess-

> ment, deplete their financial resources, and force them to capitulate to IRS demands.... In some cases, IRS management can determine that a particular taxpayer is simply 'someone to get.' In other words, they become a target of the IRS. Management will go about fabricating evidence against that taxpayer to demonstrate that he or she owes more taxes.... Management will often use a taxpayer's response as proof that they are in fact a tax protester....Based on this pretext, the IRS can then justify taking severe action contrary to the law in order to pursue the collection. The immediate and direct consequences of these actions are the deprivation of the taxpayer's lawful rights." — IRS Oversight Hearings, 09/24/97, Testimony of Jennifer Long, Revenue Agent.

Contrary to the Commissioner's assertion (Opp. Br. 8), the scope of the Para Tech examination could not have possibly encompassed the Taxpayer. Para Tech was exclusively represented at its examination pursuant to 26 U.S.C. §7521(c). Every document issued by the Commissioner in connection with the Para Tech examination bore the Para Tech taxpayer identification number, and was addressed to an official representative of Para Tech. An examination notice or information request with the Taxpayer's identification number would have been addressed to him if the scope of the Para Tech examination included the Taxpayer. It did not, and this was not a coordinated examination program case (9th Cir. tab 38).

The Commissioner essentially proposes an exemption from 26 U.S.C. §6103 — Confidentiality and Disclosure of Returns and Return Information, where an information request issued to one taxpayer should really be answered by other taxpayers.

SUPERVISORY POWER — LOWER COURT ERROR

The detailed factual issues are reached only if no administrative process is due a taxpayer, and only if the law requires determination of a deficiency in mere form. The Commissioner's brief essentially argues that the end justified the means.

> "I also ran across Revenue Officers who understood the legal and procedural requirements but they chose not to follow them, or consciously bypassed them.... As long as the tax was collected, there was really no harm done. In essence, it was really a matter of the ends justifying the means.... In one district in California I became aware that some IRS managers blatantly

disregarded the law, even though they understood it." — IRS Oversight Hearings, 09/24/97, Testimony of Darren Larsen, 13 years experience as attorney in office of IRS chief counsel.

Even if Para Tech and Atram are regarded as abusive trusts, the income must still be taxed to the one who earned it in substance. See, *United States v. Basye*, 410 U.S. 441, 450-451 (1973); citing *Lucas v. Earl* and *Commissioner v. Culbertson, supra.* Although the Tax Court was not persuaded by the evidence, *something* of substance caused Para Tech sales to greatly increase and make the income the Commissioner sought to tax. The Commissioner has attacked the business form to obscure that substance (Opp. Br. 6). In order to bury the truth and prejudice the Taxpayer with the burden of proof in court, the Commissioner did not examine or contact the Taxpayer.

Para Tech income was earned not by the Taxpayer, but by a Chilean professor who created the intellectual property and contributed that capital to the business venture, even though he did not immediately receive and hold the resulting income. See, *United States v. Consumer Life Ins. Co.*, 430 U.S. 725, 759 (1977); citing *Lucas v. Earl, supra.* The Revenue Agent did not find any income distributions to the Taxpayer, because the Taxpayer never earned or received more than his 4% share of income from the business venture.

The protections granted by 26 U.S.C. §§663, 674 are the exact reasons Para Tech was deemed a sham and not protected. The Commissioner essentially argues that the form defeats the substance (Opp. Br. 6, n2), and *United States v. Consumer Life Ins. Co.*, and *Lucas v. Earl, supra*, are inapplicable. Thousands of businesses restructure every year with far less change than Para Tech. The Commissioner basically proposes that if a business is restructured, future income is taxable to the founder of the business instead of the ones who earn it through capital investment of intellectual property.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

Tom Anderson

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